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No. 7724

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

CORINNE S. KOSHLAND,
Respondent.

On Petition for Review of Decision of the United States Board of Tax Appeals.

BRIEF FOR RESPONDENT.

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BRIEF FOR RESPONDENT.

STATEMENT OF THE CASE.

This appeal involves income taxes of respondent for the year 1930. The facts are simple and undisputed and may be briefly summarized as follows:

Respondent acquired during the years 1924 and 1926 an aggregate of 165 shares of preferred stock of Columbia Steel Corporation (hereinafter for brevity referred to as "Columbia"), which the Commissioner determined and the Board of Tax Appeals found had an original cost, for income tax purposes, of $14,-996.11. Though respondent contested before the Board the determination of the Commissioner in this regard, respondent has taken no appeal from the decision of the Board, and therefore, she is bound by such determination of original cost.

At all material times Columbia was a Delaware Corporation, with an authorized capitalization of 100,000 shares of preferred stock, of a par value of $100.00 per share, and a varying amount of shares of no par value common stock.

The preferred shares of Columbia were entitled to cumulative preferential dividends at the rate of seven per cent per annum. The charter of Columbia authorized the payment of the seven per cent dividends on the preferred stock, for the first five years of the existence of the company, either in cash or in common stock of the corporation at the rate of one share of common stock per annum for each share of preferred stock outstanding at the election of the directors. Under this authority, the directors of Columbia declared dividends upon the preferred stock, payable in common stock at the prescribed rate, for the four and one-half year period ending on June 30, 1927. At the time of the payment of each of the foregoing dividends, the earned surplus of Columbia was in excess of a seven per cent dividend upon the issued preferred stock, and upon the issuance of common stock as a dividend, surplus was in each instance debited with an amount at the rate of $7 for each share of common stock issued and an equivalent amount was credited to the common stock.

The preferred stock had no voting rights, but on the contrary, all voting rights were vested in the shares of common stock. The preferred stock was redeemable by the corporation at the sum of $105.00 per share, plus all accrued dividends, and upon any dissolution or liquidation of the company, the preferred stock was entitled to a preferential payment of $100.00 per share, plus all accrued dividends, before the common stock was entitled to any share or portion of the assets.

Respondent, as the owner of shares of preferred stock of Columbia, received during the years 1925, 1926, 1927 and 1928 shares of common stock representing dividends paid in the form of common stock for the four and a half year period ending on June 30, 1927.

Respondent continuously owned and held the 165 shares of preferred stock of Columbia from respective dates of acquisition until January 2, 1930, on which last mentioned date Columbia redeemed all of its shares of preferred stock and respondent received the sum of $17,325.00 in redemption of her 165 shares of preferred stock of Columbia.

Respondent did not report on her income tax returns any amounts for the dividends received by her in common stock of Columbia in the years 1925, 1926, 1927 and 1928.

The Commissioner of Internal Revenue treated the dividends received by respondent in common stock as non-taxable stock dividends, which operated to reduce the original cost basis of the 165 shares of preferred stock owned by respondent. The Board of Tax Appeals held that such action on the part of the Commissioner was erroneous and that respondent was entitled to measure her gain from the redemption of preferred stock upon the basis of the original cost of such shares.

QUESTIONS INVOLVED.

1. Was the common stock distributed by Columbia to respondent as a dividend upon her preferred stock, a non-taxable stock dividend, or a property dividend subject to taxation?

2. If the distribution of the common stock constituted a property dividend subject to taxation, is respondent estopped from claiming, on the redemption of the preferred stock, that the cost basis to her of the preferred shares is their cost as prescribed by the Revenue Act?

STATUTES INVOLVED.

The applicable statutory provisions are:

Revenue Act of 1926:

"Sec. 201 (a) The term 'dividend' * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913."

"Sec. 201 (f) A stock dividend shall not be subject to tax."

NOTE: Section 115, subdivisions (a) and (f) of the Revenue Act of 1928 are substantially the same as the section above quoted.

Revenue Act of 1928:

"Sec. 111 (a) * * * the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in Section 113 * * *."

"Sec. 113 (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that * * *" (The exceptions have no application and are therefore omitted.)

ARGUMENT.

I.

THE COMMON STOCK DISTRIBUTED BY COLUMBIA TO RESPONDENT AS A DIVIDEND UPON HER PREFERRED STOCK, WAS A PROPERTY DIVIDEND SUBJECT TO TAXATION.

The question as to whether a dividend declared upon cumulative non-voting preferred shares payable in common voting shares, is as to the preferred shareholder a tax-free stock dividend, or a property dividend subject to taxation, was first decided in *Tillotson Manufacturing Co. v. Commissioner*, 27 B. T. A. 913. The Board, in an exhaustive well considered opinion, held that such a dividend did not constitute a stock dividend within the purview of *Eisner v. Macomber*, 252 U. S. 189, and Section 201 (f) of the Revenue Act of 1926. In the course of its opinion, the Board stated:

"Analyzing the facts in this proceeding in the manner prescribed in Eisner v. Macomber, supra, the want of essential similarity is immediately apparent. This was not a proportional redistribution of existing or inchoate rights. There was a substantial change in the shareholder interests not only of this petitioner but of all other shareholders as well. Whether the adventitious effect of this at any given time to any one shareholder be for better or worse may serve to measure the gain or loss, but it leaves the change no less substantial. This petitioner as a preferred shareholder not only enjoyed the benefits of its preference and the assurance which the provision for cumulative dividends might give, but it also was subject to the limitations of a fixed dividend and a contingent right to vote. By this dividend, it acquired new and separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meetings.

While this did not take anything from the corporation nor anything directly from the other common shareholders except a proportionate part of the value of their shares, it is the petitioner's situation which is now being considered and the effect of the dividend upon its income alone. United States v. Phellis, 257 U. S. 156.

* * * * * * *

Although much is said in the opinion in Eisner v. Macomber, supra, about a stock dividend taking nothing from the corporation and being the opposite of a distribution of earnings, it seems to us a perversion of the essential reasoning of that opinion to regard this as the more important of the considerations. The case presented the question whether the plaintiff could constitutionally be subjected to the income tax in respect of a pure proportional common stock dividend. The primary concern was to ascertain what such dividend brought to her and whether it could be said to be income. This question was thoroughly explored, and finding that the shareholder received nothing of substance and that the corporation parted with nothing but only modified its accounts, the conclusion was drawn that she had derived no income. With a simple stock dividend, both propositions support the conclusion; but it is a plain fallacy to give them equal weight, or to infer that the effect upon the corporation would alone have induced the result reached if the effect upon the shareholder had been to give her additional rights so separate and substantial as to afford different prospects, yield different fruit, and be salable with different market considerations from those formerly existing as to her. Cf. Marr v. United States, 268 U. S. 536.

*   *   *   *   *   *   *

The respondent erred in treating the petitioner's receipt of the common shares as if it were a non-taxable stock dividend which operated to reduce the cost basis of the 6,500 shares of preferred. The petitioner correctly measured its profit from the sale of the 6,500 shares upon the basis of the entire original cost of such shares, $418,575."

The Commissioner, being dissatisfied with the decision of the Board in the *Tillotson Manufacturing Co.* case, took an appeal to the United States Circuit Court of Appeals for the Fifth Circuit. On March 14, 1935, the Appellate Court, in a unanimous opinion, affirmed the holding of the Board. (*Commisisoner of Internal Revenue, Petitioner, v. Tillotson Manufacturing Co., Respondent,* reported in Commerce Clearing House

Standard Federal Tax Service Volume III Under Court Decisions, at page 9645.) The Circuit Court of Appeals in the course of its opinion stated:

> "The sole question involved is whether a dividend declared upon cumulative non-voting preferred shares payable in common voting shares is a stock dividend, tax free within the purview of Section 201 (f). If the dividend was not subject to tax, the Commissioner's determination was correct. If the dividend was subject to tax, the respondent correctly measured its profit from the sale of the preferred stock.
>
> The Commissioner urges that under the decisions of the Supreme Court of the United States, and particularly Eisner, Collector, v. Macomber, 252 U. S. 189, this particular distribution of common stock is not subject to tax, and that the Board of Tax Appeals erred in its order and decision. In that case, common stock was distributed pro rata to common stockholders. The decision that the dividend was not subject to tax was based partly upon the proposition that there was no severance of the corporate assets, and hence no income received by the distributee. However, it was also pointed out in that case, as a material fact, that the dividend did not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before.
>
> Two tests were thus established for distinguishing a taxable from a non-taxable dividend in stock: (1) Severance of assets from the corporation, and (2) alteration of the pre-existing proportionate interest of the stockholders.

In the instant case the first test was met. There was no severance of corporate assets. The distribution was made to its preferred shareholders by the corporation, not in stock of another corporation, not from its own treasury stock, but from its own unissued stock.

The second test was not met. The preexisting proportionate interest of the stockholders was substantially altered.

*   *   *   *   *   *   *

United States v. Phellis, 257 U. S. 156, presented the case of a reorganization resulting in the formation of a company not substantially identical with the first. The court, holding that a dividend in stock of the old company paid in stock of the new company was taxable as individual income, stressed the fact that the individual stockholders of the old company 'received assets of exchangeable and actual value severed from their capital interest in the old company, proceeding from it as a result of a division of former corporate profits, and drawn by them severally for their individual and separate use and benefit'.

The court also stated that the liability of a stockholder to pay an individual income tax must be decided by the effect of the transaction upon the individual.

Weiss, Collector, v. Stearn, 265 U. S. 242, held that a dividend in stock was non-taxable upon the ground that it constituted an issuance and exchange of certificates representing the same preexisting interest. The court again declared that to constitute gain 'separated from the original capital interest', the stockholder must receive 'a thing really different from what he theretofore had'.

In Marr v. United States, 268 U. S. 536, the distribution of stock was held to constitute taxable income. The court grounded its decision upon the fact that after the distribution the stockholders no longer owned 'the same proportional interest of the same kind in essentially the same corporation'.

It is true that there is a distinction between the instant case and those cited. Here the dividend issued to the preferred stockholders in payment of the accrued preferred dividends was unissued stock of the corporation itself, not stock in any other corporation. However, the right to share in assets of the company upon dissolution, and in the earnings of the corporation upon the declaration of dividends, was materially altered and changed. Each preferred stockholder, in consideration of relinquishing his rights to the accrued preferred dividends, secured new voting rights, and additional property rights which might well afford him a different and greater market with an increased money return. In fact the precise situation was presented, described under different circumstances, in United States v. Phellis, supra, that the preferred stockholders received assets of an exchangeable and actual value proceeding from their capital interest in the old company, drawn by them for their individual and separate use and benefit.

We think that the mere circumstance that this transformation was effected within one single organization does not alter the applicability of these rules. The Commissioner erred in applying to the transaction one test only of those laid down in Eisner, Collector, v. Macomber, supra, and the other decisions above cited. Applying the other test, namely, that of alteration of proportionate interest, the preferred stockholders received taxable income, and respondent did not err in the computation of its taxable gain.

The decision of the Board of Tax Appeals is affirmed."

In *James H. Torrens v. Commissioner,* 31 B. T. A. 787, the converse of the situation presented in the *Tillotson* case was involved, in that a corporation distributed its shares of preferred stock as a dividend to its common stockholders. The syllabus of the decision reads as follows:

> "Where both common and preferred shares are outstanding when a dividend is declared upon voting common stock and paid in the form of non-voting cumulative preferred shares at par value, such dividend is not a tax-free stock dividend. Tillotson Manufacturing Co., 27 B. T. A. 913."

Petitioner admits that the decision in the *Tillotson* case is contrary to his contention. (Brief for Petitioner, page 19.) He endeavors to distinguish the cases on the ground that in the *Tillotson* case "stock was issued to pay accumulated cash dividends in arrears and the stockholder was not compelled to accept the stock in satisfaction, but could await such time as the corporation had funds to pay in cash", while "in the instant case the taxpayer had no election". It will be observed that the decision in the *Tillotson* case is in nowise dependent upon whether or not the stockholder was compelled to accept the stock dividend at the time it was declared or wait until such time as the corporation had funds on hand with which to pay the dividend in cash. The distinction which petitioner endeavors to make between the two cases is obviously non-existent. It therefore follows that if this Court adopts the rule laid down by the Circuit Court of Appeals for the Sixth Circuit, the judgment of the Board of Tax Appeals must be affirmed.

Despite the fact that the above cases, which are the only adjudicated cases on the subject, are adverse to his contention, petitioner contends that these decisions are erroneous for the following reasons:

(a) That respondent's investment in Columbia remained the same after receipt of the common shares.

(b) That all Revenue Acts beginning with the Revenue Act of 1921 have provided that "a stock dividend shall not be subject to tax" and the Regulations of the Commissioner issued in connection therewith have stated that "the issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock". Arguing from the foregoing premise, petitioner concludes that the Congress by declaring that "a stock dividend shall not be subject to tax", intended to exempt from taxation a dividend such as was received by respondent in the instant case.

Taking up the first contention of petitioner, the mere statement thereof is a refutation of its validity. Before the stock dividend declared by Columbia, the preferred stockholders had solely a limited participation in the assets, which was fixed in amount and extent. All that the preferred stockholders were entitled to receive by virtue of their holdings was (a) preferential payment of cumulative dividends in a specified amount, and (b) a preferential right to receive $100.00 per share, plus accrued dividends, and no more, upon dissolution or liquidation and any residual value of the assets was distributable ratably to the common stockholders, or (c) payment of $105.00 per share, plus accrued dividends in case of redemption. When respondent received the shares of common stock as a dividend upon the preferred shares, no diminution of her former interest occurred; on the contrary such former interest was increased, because respondent and all other preferred stockholders owned additionally a proportional interest in the residual assets of Columbia remaining over and above the preferential payment to the preferred stockholders. The common stock thus received could have been sold, and after any such sale the preferred stockholders would, aside from the proceeds of sale, still have maintained their identical financial position in Columbia. Manifestly, this situation is far different from that where a common stockholder receives, by way of stock dividend, additional shares of common stock, as a result of which his proportional interest in the corporate property still remains identical, and he has two pieces of paper in lieu of one, but with no greater nor any less interest in the corporate assets.

The final contention of petitioner is that the statutory provision prescribing that "a stock dividend shall not be subject to tax", was intended to exempt from taxation as a dividend not only dividends in stock which did not change a stockholder's proportional interest in the corporation, but also dividends which did materially change the stockholder's proportional interest.

It is well recognized that a

> "guide to the meaning of a statute is found in the evil which it is designed to remedy; and for this the court properly looks at contemporaneous events, the situation as it existed, and as it was pressed upon the attention of the legislative body."
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> *Church of the Holy Trinity v. United States,* 143 U. S. 457.

See also

> *United States v. Union Pacific Railroad Co.,* 91 U. S. 72.

Viewing the situation which led to the original enactment of the statutory provision in question in the light of the foregoing canon of construction, it appears that on March 8, 1920, the Supreme Court of the United States in *Eisner v. Macomber,* 252 U. S. 189, held that that portion of Section 2 (a) of the Revenue Act of 1916 which provided that a

> "stock dividend shall be considered income, to the amount of its cash value"

was unconstitutional, because it taxed something as income which was not income. The stock dividend involved in *Eisner v. Macomber* had reference to a dividend of a corporation which had only one class of stock outstanding and the effect of which was not to change in the least respect the proportional interest of the stockholders. A similar unconstitutional provision existed in the Revenue Act of 1917 (Section 1211) and the Revenue Act of 1918 (Section 201 (c)).

When the Revenue Act of 1921 was under consideration by Congress, the lack of power in Congress to tax a stock dividend was thus known, and the Secretary of the Treasury of the United States wrote a letter to the Chairman of the Ways and Means Committee of the House of Representatives referring to the loss of revenue that might be expected to result from the decision in *Eisner v. Macomber.* (Congressional Record Volume 59, Part 5, page 4464.) It was in this setting and to correct what had been judicially declared the exercise of an unlawful power on the part of Congress, that the Revenue Act of 1921 not only eliminated from the taxing statute the attempted taxation of a stock dividend, but affirmatively recognized such lack of power by including in the Revenue Act of 1921 (Section 201 (d)) a provision setting forth that a stock dividend shall not be subject to tax.

As aptly stated by the Board of Tax Appeals in *Tillotson Manufacturing Co. v. Commissioner,* supra:

> "When it is realized that the occasion for the original prototype of Section 201 (f), namely, Section 201 (d) of the Revenue Act of 1921, exempting stock dividends from tax, was the decision of the Supreme Court in Eisner v. Macomber, supra, annulling so much of Section 2 (a) of the Revenue Act of 1916 as included stock dividends among those taxable, it becomes clear that the subsequent statutory exemption was only as broad as the decision, and hence that the intention was not to exempt stock dividends by any general or

> loose concept, but only such as could not constitutionally be taxed because they were not income. The term 'stock dividend' is not of itself so free from ambiguity as to preclude construction, and hence the statutory exemption must be construed to promote the intendment disclosed by the history and circumstances of its enactment. This requires that it be confined to such as have the attributes which distinguished them from the receipt of income by the shareholder. Only those which place the shareholder in no essentially different position are exempt."

Let us assume for the moment the validity of petitioner's argument, viz., that Congress by declaring that "a stock dividend shall not be subject to tax" intended to exempt from taxation a dividend paid upon preferred stock in the form of common stock, notwithstanding that such a dividend is not constitutionally immune from taxation under the decision of *Eisner v. Macomber*. Such an assumption, however, gives no comfort to the petitioner, because the mere nonrecognition by Congress of an otherwise taxable dividend cannot, upon a subsequent sale, affect the cost basis of the shares of stock in respect of which the dividend was paid, unless Congress has made appropriate provision for the adjustment of such cost basis in the sections of the Revenue Act which prescribe the method and the manner of determining gain upon disposition of property.

The redemption of the preferred stock by respondent occurred in the year 1930 and therefore the Revenue Act of 1928 governs the determination of computing the gain upon such redemption. Section 111 (a) of that Act provides that the gain from any disposition of property acquired after March 28, 1913, shall be the excess of the amount realized therefrom over the basis provided in Section 113. Section 113 prescribes this basis as being *"the cost of such property"*, except in certain specified cases.

There can be no question, but that the statute creates no exception to the prescribed basis, viz., "the cost of such property", in respect of shares of stock upon which a stock dividend has been declared which could have been lawfully taxed at the time of receipt of such dividend. Such a situation is different from the type of the stock dividend which was the subject matter of *Eisner v. Macomber,* where each stockholder's proportional interest in the assets of the corporation was the same after the declaration of the stock dividend as it was before; in such a case, automatically the original total cost must be spread ratably not only among the shares originally held, but among those received as a stock dividend. Such a factual situation, however, does not exist in the instant case, where petitioner contends that Congress has exempted taxable distributions from tax at the time they were made. (Petitioner's Brief pages 20-1.) The Commissioner by his regulations has attempted to engraft by administrative fiat an exception to the general rule of cost basis prescribed by Section 113 of the Revenue Act of 1928, in addition to the specified statutory exceptions contained therein. Such regulations are an attempt to alter and change the law as to cost basis on disposition of property. "The Secretary of the Treasury cannot, by his regulations, alter or amend a revenue law." *Morrill v. Jones,* 106 U. S. 466. To the same effect see *Maryland Casualty Co. v. U. S.,* 251 U. S. 348.

II.

RESPONDENT IS NOT ESTOPPED FROM CLAIMING THAT THE COST BASIS OF THE PREFERRED SHARES REDEEMED IS THEIR COST AS PRESCRIBED BY THE REVENUE ACT.

Estoppel is an affirmative defense, which must be pleaded by the party relying thereon, and such party must, in order to prevail on his plea of estoppel, prove that all of the essential elements of estoppel are present.

> *Helvering v. Brooklyn City R. Co.,* 72 Fed. (2d) 274;
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> *North Port Shores, Inc. v. Commissioner,* 31 B. T. A. 1013.

In *United States v. S. F. Scott & Sons, Inc.,* 69 Fed. (2d) 728, the Circuit Court of Appeals for the First Circuit defined the elements necessary to create an estoppel thus:

> "To constitute estoppel (1) there must be false representation or wrongful misleading silence. (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or statements of the persons against whom an estoppel is claimed."

The sole evidence upon the subject matter of estoppel is the following stipulation entered into at the trial before the Board between counsel for the parties:

> "The petitioner, Corinne S. Koshland, did not report on her income tax returns any amounts for the dividends received by her in common stock of the Columbia Steel Corporation in the years 1925, 1926, 1927 and 1928." (Transcript, page 59.)

Analyzing the essential elements of estoppel in the light of the foregoing evidence:

1. There was no false representation or wrongful misleading silence on the part of respondent. If any act of commission or omission can be attributed to respondent, it resolves itself solely into compliance with the Treasury Regulations promulgated and in effect at all relevant dates. (Article 1548 of Regulations 69 and Article 628 of Regulations 74. See also I. T. 2538, IX-1 Cumulative Bulletin, page 144.)

2. Respondent's error (if it be considered an error) in failing to report these dividends in her income tax returns for previous years, did not originate in any statement of fact. At most, respondent's failure to return such dividends was an erroneous interpretation by her of the law, which interpretation was concurred in by the Commissioner. As stated in *Salvage v. Commissioner,* a decision of the United States Circuit Court of Appeals for the Second Circuit (decided on March 18, 1935, and reported in Prentice-Hall 1935 Federal Tax Service, Volume 1, under Court Rulings and Decisions at page 970):

> "So far as appears, the petitioner's failure to report the income in 1922 was due to an innocent

mistake of law; he made no false representation of fact, and may, for all that this record discloses, have mentioned the purchase in his 1922 return. Under such circumstances, we cannot find an adequate basis for an estoppel."

3. There is no evidence that the Commissioner (who is now claiming the benefit of estoppel) was ignorant of the true facts with respect to the receipt of the mooted dividends by respondent during the years 1925-1928. Ignorance of the true facts is a prime requisite to the creation of an estoppel. For all that appears, the Commissioner was in possession of the facts and, following the promulgated Regulations and rulings, neither could nor would require the taxation of such dividends, until such time as the Regulations had been changed.

4. Finally, there is no evidence whatever that petitioner has been adversely affected by the failure of respondent to include in her income tax returns for the years 1925, 1926, 1927 and 1928 the value of the dividends received by her in such years in common stock of Columbia. If respondent had reported the value of such shares of common stock during the years in question, it does not follow that an income tax would have been payable by her, as income tax liability arises only if gross income exceeds allowable losses and other deductions; there is no evidence in the record that respondent would have had any taxable net income during any of the years in question, even had these dividends been included in gross income.

As the burden of proving estoppel rests upon the party pleading the same (in this case petitioner) and he having failed to prove affirmatively the necessary elements of estoppel, the Board correctly held that respondent is not estopped from asserting that the common stock distributed by Columbia to her as a dividend upon her preferred stock was a taxable dividend. (See *Brewerton v. United States*, a decision of the United States Court of Claims, reported in Prentice-Hall 1935 Federal Tax Service, Volume 1, under Court Rulings and Decisions at page 579.)

We shall briefly advert to a number of cases which are directly in point and where the facts show that petitioner's defense of estoppel is untenable.

In *United States v. S. F. Scott & Sons, Inc.*, supra, the Commissioner erroneously assessed a deficiency tax against the appellee corporation, instead of an individual taxpayer. The appellee corporation paid the tax, and filed suit for recovery. Appellant United States pleaded estoppel. The Court disposed of this defense thus:

> "It is quite evident here that the error originated in the misapprehension of the Commissioner as to the law applying to the assessment of the tax in question, and that the appellee did nothing and said nothing intending to mislead or which could have misled the Government as to any of the facts involved.
>
> *   *   *   *   *   *   *
>
> 'I know of no case which holds that an estoppel, for which the Government contends in this case, can be held to arise where the conduct on which it rests is the conduct of the party

> claiming the benefit of the estoppel in mistakingly judging, as here, what the true rules of law are and where no element of fraudulent concealment or misrepresentation on the part of the other party is shown.' "

In *Bigelow v. Bowers,* 68 Fed. (2d) 839, the exact converse of the situation presented in the instant case was before the Circuit Court of Appeals for the Second Circuit. In the *Bigelow* case, the plaintiff had paid an income tax, pursuant to the provisions of Section 2 (a) of the Revenue Act of 1916, on the cash value of a stock dividend of a character which was precisely within the purview of the subsequent decision in *Eisner v. Macomber.* Subsequently plaintiff sold the shares of stock originally held, together with the shares received as a stock dividend, and in reporting the sale, plaintiff added to his cost of the original shares, the cash value of the stock dividend shares which had previously been returned as a dividend subject to tax. The Commissioner refused to allow the additional cost to be added, upon the ground that under the decision in *Eisner v. Macomber,* the shares received as a stock dividend were not taxable and therefore gave no greater cost. The plaintiff on appeal, urged that the result of the Commissioner's action was to impose a double tax, viz., an erroneous tax on the stock dividend and a tax on the value thereof when sold. In sustaining the Commissioner, the Circuit Court of Appeals said:

> "That the plaintiff has been taxed on a gain derived from the sale of his stock gives him no just cause for complaint if the computation of the gain was correct. * * *"

In *Ohio Brass Co. v. Commissioner*, 17 B. T. A., page 1199, there was involved the question of the inclusion in gross income for the year 1921 of a profit upon a sale made by petitioner; petitioner claimed that the profit was realized in the year 1920, but petitioner had not included the profit in its income tax return for the year 1920, and the question which the Board was called upon to decide was whether petitioner should be estopped to deny that the profit was not taxable to it in the year 1921. The Board said:

> "Having raised the question of estoppel, it is incumbent upon respondent to show that the elements of the doctrine are present. * * * It is said in Henshaw v. Bissell, 18 Wall. 255, that for the application of the doctrine of equitable estoppel, 'there must be some intended deception in the conduct or declarations of the party to be estopped or such gross negligence on his part as to amount to constructive fraud.'"

In *United States Trust Company of New York v. Commissioner,* 13 B. T. A., page 1074, the petitioner attempted to set up an estoppel as against the Commissioner. In denying the defense the Board stated:

> "It is another element of equitable estoppel that the party claiming the estoppel should have had the right to rely upon the position taken by his adversary. Here there was no misrepresentation of facts; the ruling was solely one of law. Petitioner had claimed that these taxes accrued rateably; the respondent ruled that they accrued when payable. Each was in a similar position with respect to ability to determine what was the law. Petitioner seeks to avoid this con-

clusion by urging that the statute left it to the sound discretion of the Commissioner to determine when the franchise tax should be deducted, and cites section 212 (b) of the Revenue Acts of 1918 and 1921 and Hyams Coal Co. v. United States, 26 Fed. (2d) 805. In some matters discretion is lodged in the Commissioner, but with respect to such deductions as taxes the Commissioner has no such discretion as the taxpayer urges. United States v. Anderson, supra. The statute provides when they shall be deducted. We see no ground upon which petitioner could be said to have been justified in relying upon the ruling of the Commissioner upon a question of law to the extent necessary to constitute an estoppel. We are of the opinion that if there are circumstances under which the United States may be estopped from collecting taxes legally due except for such estoppel, they do not exist in the instant case."

The most that can be said in the instant case is that the failure of respondents to report the dividends in her income tax returns constituted a mutual mistake of law on the part of respondent and the Commissioner. But "a mutual mistake of law is no foundation for estoppel".

The Sugar Creek Coal & Mining Co. v. Commissioner, 31 B. T. A. 344.

See, also,

Tide Water Oil Co. v. Commissioner, 29 B. T. A., 1208.

The numerous cases cited by petitioner are not opposed to the uniform trend of the authorities from which we have quoted and to which we have adverted.

As pointed out in the *Sugar Creek Coal & Mining Co.* case, supra, where most of the cases cited by petitioner are referred to in footnotes:

> "Cases where the taxpayer has knowingly postponed the tax by an affirmative act or statement upon which the Commissioner reasonably relied, do not support the broad rule urged upon us here. And the doctrine of estoppel is not to be confused with that of election."

It would unduly lengthen this brief to refer to the facts in all of the cases cited by petitioner, but it may not be amiss in passing to point out that in *Stearns Company v. United States,* 291 U. S. 54, the estoppel relied on by the Government was based upon a request made by the taxpayer to the Commissioner; that in *Burnet v. San Joaquin Fruit & Investment Co.,* 52 Fed. (2d) 123, The San Joaquin Fruit & Investment Co. appeared before the Board of Tax Appeals and described itself as the "taxpayer", and later attempted to deny that it was the taxpayer; that in *Askin & Marine Co. v. Commissioner,* 66 Fed. (2d) 776, the taxpayer misrepresented the fact that it had ascertained in a prior year that certain debts had become worthless; that in *Haag v. Commissioner,* 59 Fed. (2d) 514, the taxpayer represented in her tax return that she was a member of a certain partnership and later attempted to deny such membership. All the other cases cited by petitioner are likewise readily distinguishable upon their facts and accord with the decisions relied upon by respondent.

It may fairly be stated, that the record in this case and the regulations and the rulings of the Commissioner which were in existence at the time of receipt of each of the dividends in question affirmatively show that the failure of respondent to report on her income tax returns for the years 1925 to 1928 any amounts for the dividends received by her in common stock of Columbia Steel Corporation was due solely to a mutual mistake of law; that the Commissioner was in possession of all of the facts appertaining thereto, and neither relied nor had the right to rely upon such failure on the part of respondent. Under such circumstances, the petitioner's defense of estoppel must fail, just as surely and as rightfully as did the taxpayer's defense of estoppel fail in *Bigelow v. Bowers*, supra, where under a mutual mistake of law on the part of the taxpayer and the Commissioner, a stock dividend concededly immune from tax, was taxed and notwithstanding, no cost basis was allowed to the taxpayer for the cash value of the stock dividend taxed, when the stock received as a dividend was sold. Incidentally, it affirmatively appeared in the *Bigelow* case that the taxpayer actually was subject to and paid a tax in both instances, whereas in the present case there is no evidence that the inclusion of the dividend in respondent's return would have given rise to any tax liability.

CONCLUSION.

The decision of the Board of Tax Appeals was in accordance with law and should be affirmed.

Dated, San Francisco,
May 6, 1935.

Respectfully submitted,
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